



March 28, 2014

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 2006-1506

Via email to pubcom@finra.org

Re: Comments on the Proposed Amendment to FINRA Rule 4210

Dear Ms. Asquith:

Thank you for the opportunity to comment on the proposed amendment to FINRA Rule 4210. Robert W. Baird & Co. Incorporated is a dually registered broker-dealer and investment advisory firm. We typically contribute our comments to FINRA on proposed rules and amendments through industry representative groups of which we are members. However, given the unwarranted scope, breath, and anticipated high implementation costs of compliance associated with the proposed amendment to Rule 4210, we thought it was necessary to provide our separate comments.

Reducing counterparty risk to individual firms and systemic risk that is present in the To Be Announced (TBA) market is a laudable goal. Nonetheless, we believe simple changes could be made to the proposed amendment to Rule 4210 that would accomplish that goal without burdening FINRA members and their clients with extraneous regulatory obligations and the associated costs.

We appreciate that the proposed amendment was informed by the recommendation issued by the Treasury Market Practices Group (TMPG) of the Federal Reserve Bank of New York. However, as we are not a primary dealer, we were not given an opportunity to contribute to the shaping of that recommendation, and, as a FINRA member we believe it is necessary for us to present our perspective on the shifting aspects of that recommendation in the form of a proposed rule and on its significantly problematic aspects. While primary dealers may be well-equipped to comply with the TMPG recommendation and the proposed amendment to FINRA Rule 4210, many FINRA members and their clients find the recommendation and proposed amendment to be unduly burdensome and disruptive to the market. Therefore, one of our suggested improvements to the proposed amendment runs counter to the TMPG recommendation, while others run counter to provisions present only in the FINRA proposed amendment.

I. Limit Covered Agency Securities

The proposed amendment mirrors the scope of the TMPG recommendation with respect to covered securities. In FINRA Notice 14-02 the subject securities are given the name Covered Agency Securities and include:

- TBA transactions for which the trade date and contractual settlement date is greater than one business day, inclusive of ARM transactions

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- Specified pool transactions for which the difference between the trade date and contractual settlement date is greater than one business day
- CMOs issued in conformity with a program of an Agency for which the difference between the trade date and contractual settlement date is greater than three business days

We believe the scope of the Covered Agency Securities should be changed to eliminate specified pool transactions unless the difference between the trade date and contractual settlement date is greater than three business days. The specified pool market is distinct from the TBA market in that the identity of the securities to be delivered is specified at the time of the trade, much like in other securities markets. Other types of investment securities, including equities and high-yield bonds, with regular way settlements of three business days are not subject to margining in cash accounts. We see no reason to distinguish among these investment securities, each of which presents counterparty and systemic risk.

While FINRA has indicated a desire to have the TMPG recommendations inform the proposed amendments, clearly there are points of divergence where the insertion of FINRA's expertise was deemed more important than consistency between the two. We believe this is one point where a divergence between the two is warranted.

II. Remove the Concepts of Non-Exempt Accounts and Mandatory Maintenance Margin

The proposed amendment would require that FINRA member firms differentiate between exempt and non-exempt counterparties and collect maintenance margin from non-exempt accounts. The regulatory burden on FINRA member firms to comply with this provision of the proposed amendment far outweighs any incremental benefit to accomplishing the stated goal of reducing counterparty and systemic risk.

The use of exempt and non-exempt classifications as outlined in the proposed amendment will be burdensome for firms that have not previously needed to make this determination on the subject clients. This burden will continue indefinitely as firms work to add new clients and to periodically confirm the status of existing clients. The difficulties inherent in accurately maintaining a list classifying clients according to an arbitrary cutoff when these clients have little incentive to promptly provide the requested information should not be minimized. This will require firms to devote substantial resources to this task.

The collecting of maintenance margin could also significantly increase the compliance burden on FINRA member firms, assuming of course non-exempt clients continue to be active in this market and to use FINRA member firms for these transactions. We are adding the capability to perform margining as envisioned by the proposed amendment, and due to cost considerations (set forth in detail in Section IV of this letter), we will be utilizing our firm's internal resources and a manual process. The mandatory collection of maintenance margin from non-exempt clients could potentially add to the frequency of the movement of margin and result in the need for additional personnel to comply with the proposed amendment.

There may be additional unintended consequences to this provision of the proposed amendment. We anticipate affected non-exempt clients will be reluctant to agree to a mandatory maintenance margin provision. From a client's perspective, the posting of this maintenance margin will add counterparty risk since the client's money is now exposed to the risk of default by the dealer. We could subsequently lose that business to competitors that are not members of FINRA or these clients could simply exit the market. As a result, liquidity within the market of the subject securities could be harmed.

The TMPG recommendation does not require that firms collect maintenance margin. The TMPG recommendation also does not include the concept of exempt or non-exempt accounts. Before burdening FINRA member market participants with this onerous provision it would seem reasonable for rule makers to quantify the extent of counterparty and systemic risk caused by non-exempt clients operating in the TBA market.

Even if it is the case that non-exempt counterparties are, and continue to be, active participants in the trading of Covered Agency Securities, other provisions of the proposed amendment are sufficient to address this issue. FINRA member firms will be required to perform a credit risk analysis of each counterparty, to daily mark-to-market covered transactions, and to collect variation margin when a de minimis transfer amount is exceeded. In addition, through their own risk management processes, firms may decide on their own to require maintenance margin for particular counterparties. These other provisions of the proposed amendment add several layers of protection which heretofore did not exist, and do so without overburdening the limited resources of FINRA member firms.

Finally with respect to exempt and non-exempt accounts, Supplemental Material .04 states that the determination of whether an account qualifies as an exempt account shall be made based on the beneficial owner of the account. The proposed Supplementary Materials creates enormous burdens for FINRA members that deal with money managers and other institutions that serve as agents for a large number of clients. We would like to confirm that the established principles regarding master and subaccounts, most recently addressed by FINRA in Regulatory Notice 10-18, remain unchanged. And furthermore, as noted in Regulatory Notice 10-18, where "there are legitimate business arrangements where the identities of the beneficial owners are not disclosed to the firm", that this Supplemental Material .04 does not change FINRA member firm's obligations with respect to these unidentified beneficial owners.

III. Allow Firms' Credit Risk Analysis to Determine De Minimis Transfer Amount

Within the industry, there has been adoption of the SIFMA standard Master Securities Forward Transaction Agreement (the "MSFTA"). The MSFTA is flexible in that the parties can negotiate an increased or reduced de minimis transfer amount ("Minimum Transfer Amount" per the verbiage of the MSFTA) depending on the perceived credit risk. While many MSFTAs are being put in place with a Minimum Transfer Amount of \$250,000, there have been negotiations between parties to both increase and lower that Minimum Transfer Amount where it made sense to do so. We recommend that firms continue to be granted this flexibility to base their counterparty exposure levels on a credit risk analysis rather than on a one size fits all dictum that does not take into account the unique characteristics of each counterparty.

The imposition of a de minimis transfer amount of no greater than \$250,000 is unnecessary in light of other provisions of the proposed amendment. Under the proposed amendment firms will be performing and documenting their credit risk analysis of counterparties. In addition, firms will be taking a capital charge for any uncollected margin amounts. Any one of these provisions of the proposed amendment by itself would significantly reduce both counterparty and systemic risk. We submit that including all three provisions together is over engineering a solution to the problem being addressed.

Instead of imposing a de minimis transfer amount, we propose allowing firms to make use of the credit risk analysis mandated by the proposed amendment to set an appropriate de minimis transfer amount on a client-by-client basis. The TMPG recommendation embraced this flexible approach and did not even include the additional requirement of a capital charge for uncollected margin amounts.

IV. In Conclusion: Simplify the Rule so Firms Can Comply in a Cost Effective Manner

As we set forth above, the goals of reducing counterparty and systemic risk can be accomplished with a simplified version of the proposed amendment. The cost of implementation and compliance with the proposed amendment would be substantially reduced by such a simplification.

When the TMPG recommendation was issued, we, like many firms without a margining department in place, began to investigate our alternatives. We quickly learned that we would be choosing from a menu of bad options. Each option was expensive and only partially resolved our issues. These options included purchasing special software to assist in margining functions, hiring a third party vendor to manage our margining responsibilities, or building this capability in-house.

The cost of purchasing specialized software to manage the bilateral margining of securities is high. We have received a quote in excess of \$600,000 to purchase and implement a software system to accomplish this task. The quote also required an annual fee of approximately \$100,000. Even with the specialized software we would likely need additional internal resources to run the software and initiate margin calls.

We have also investigated outsourcing the management of bilateral margining of the subject securities. Our research indicated the costs associated with this would be approximately \$400,000 per year. Even with an outsourced solution there would still remain the tasks of negotiating margining agreements and communicating with affected clients to gather the requisite authority to enter into such agreements.

Because of the high costs associated with either purchasing specialized software to manage the bilateral margining process or outsourcing the process to a vendor, we are building a comprehensive in-house capability from scratch. Under the TMPG recommendation we were confident that we could build a workable process in-house. However, as the additional complexities of the FINRA proposed amendment have come to light we are extremely concerned about the difficulties inherent in complying with the proposed amendment.



By reducing the number of potentially affected securities by only including specified pool transactions with a greater than three day settlement, by eliminating the exempt/non-exempt classifications and the associated maintenance margin, and by limiting the number of margin calls between low risk counterparties using a flexible approach to setting de minimis transfer amounts the proposed amendment could be made more workable while still greatly reducing counterparty and systemic risk.

We appreciate the opportunity to comment on the proposed amendment to Rule 4210 and your consideration of our thoughts.

Sincerely,

Charles M. Weber
Managing Director and Senior Associate General Counsel
Robert W. Baird & Co. Incorporated